Project	**Annual Improvements – 2008-2010 Cycle**
Topic	**IAS 40 – Change from fair value model to cost model**

Purpose of this agenda paper

1. This agenda paper summarises the staff's analysis of the comment letters received on the IAS 40 *Investment Property* issue of 'change from fair value model to cost model' that was included in the exposure draft of proposed *Improvements to IFRSs* (ED) published in August 2009. This paper includes:

   (a) **background of the issue**;

   (b) a **summary background of the respondents**;

   (c) **analysis of specific comments** including staff recommendations and questions for the IFRIC; and

   (d) **other issues** for this project and related questions for the IFRIC.

Background of the issue

2. In December 2008, the Board deliberated a potential inconsistency between IAS 40 *Investment Property*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 2 *Inventories* when an entity determines there is a change in use of an investment property. At that meeting, the Board decided to include in the Exposure Draft of proposed *Improvements to IFRSs* (ED), published in August 2009, a proposed amendment to IAS 40 to:

(a) remove the requirement to transfer investment property to inventory when there is the 'commencement of development with a view to sale' (IAS 40.57(b),

(b) add a requirement for investment property for which an entity has determined there is a change in use and the entity has determined it will sell the investment property to be displayed as a separate category in the statement of financial position, and

(c) require disclosures consistent with IFRS 5 when an entity has determined there is a change in use and the entity has determined it will sell the investment property (whether or not the criteria in IFRS 5 are met).

3. See December 2008 Board Agenda Paper 11C[1] for additional background information.

Summary background of the respondents

4. A total of 74 comment letters were received on the omnibus Exposure Draft *Improvements to IFRSs* published in August 2009 (ED). The respondents included accountancy bodies, accounting firms, preparers (and preparer representative groups), regulators, standard setters and others. They represent the major regions of the world including Africa, Asia-Pacific, Europe, North America and international organisations. Additional demographic information on the respondents is provided in Agenda Paper 5G.

5. Of the 74 comment letters received on this ED, 50 comment letters included comments directly on the issue of this paper.

[1] The relevant Observer Note can be obtained at http://www.iasb.org/NR/rdonlyres/D52F6DD2-26A6-440D-B920-A87082654254/0/AIP0812b11Cobs.pdf

Analysis of specific comments

6. The 50 comment letters were approximately split between those supporting and those disagreeing with the proposed amendment. Several of the comment letters include comments for consideration by the Board addressing several specific comment topics. The comment topics can be summarized as:

   (a) responses to Invitation to Comment Question 5 asking whether this issue should be included within *Improvements to IFRSs* or should a **separate project** be undertaken;

   (b) proposed **removal of requirement to transfer** investment property carried at fair value to inventory; and

   (c) proposed requirement to apply **IFRS 5 disclosures**.

7. Each of the comment topics are analysed in detail by the staff. Specific staff recommendations are included for each comment topic and the **overall staff recommendation and questions for the IFRIC** are included at the end of the 'Analysis of specific comments' section.

Separate project

8. In the ED, the Board asked constituents to respond to its specific Question 5:

   > The Board proposes to amend IAS 40 *Investment Property* to remove the requirement to transfer investment property carried at fair value to inventory when it will be developed for sale, to add a requirement for investment property held for sale to be displayed as a separate category in the statement of financial position and to require disclosures consistent with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Do you agree that the proposed amendment should be included within *Improvements to IFRSs* or should a separate project be undertaken to address this issue? If you believe a separate project should be undertaken, please explain why.

9. Approximately half of the comment letters (that included a response to the IAS 40 proposed amendment) disagreed with the proposed amendment. Additionally, 14 comment letters specifically responded to the Board's Question 5 expressing their view that a separate project should be undertaken to comprehensively review and address this issue.

10. There is a significant split between constituents in favour of and those that disagree with the proposed amendment. Additionally, approximately one-third (of those that included any response to the IAS 40 proposed amendment) directly responded to the Board's Question 5 supporting a separate project be undertaken for this issue. The reasons given for supporting this view include the two main technical concerns raised on this proposed amendment that are analysed in detail below ('removal of requirement to transfer' and 'IFRS 5 disclosures). Several respondents also noted a lack of clarity questioning if the proposed amendment applied only to investment property measured at fair value or also investment property measured at amortised cost. Several respondents stated they 'do not support finalisation of the amendment to IAS 40 without a comprehensive analysis of all the related issues being carried out' and others stated 'we do not believe that this amendment should be progressed either in the context of the annual improvements process or in a separate project.'

11. Therefore, the staff recommends that the IFRIC recommend that the Board include this issue on the Board's list of future projects to ensure a comprehensive review of all related issues is performed. However, given the Board's current active projects, the staff recommends an active project not be started until some of the current active projects are completed and devoted staff resources become available.

Removal of requirement to transfer

12. Approximately half of the respondents commenting on the proposed amendment to IAS 40 disagree with the proposal to remove the requirement to transfer assets from investment property to inventory, if certain conditions are met. Many of these respondents stated that this proposed amendment is not consistent with the facts and circumstances of the changes in management's intent. That is, when management changes the use for which the property is to be used, from use as an investment property, to redevelopment for sale, the accounting should reflect that change in use. Many of these respondents also referenced the conflict between this proposed amendment and the amendment to IAS 16 included in the *Improvements to IFRSs* issued in May 2008 that requires property, plant and

equipment to be transferred to inventory, if certain conditions are met. Other respondents pointed out that continuing to require transfers in some situations (listed in paragraph 57 of IAS 40) while proposing this amendment to preclude transfers in other situations is not internally consistent within IAS 40.

13. One of those respondents stated:

> We do not support the proposal to amend IAS 40 *Investment Property* to remove the requirement to transfer investment property (IP) carried at fair value to inventory when it will be developed for sale, to add a requirement for IP held for sale to be displayed as a separate category in the statement of financial position, and to require disclosures consistent with IFRS 5. Accordingly, we believe that this amendment should not be progressed either in the context of the annual improvements process or in a separate project.
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> We consider that prohibiting an entity from transferring a property from IP to inventory when it has in the normal course of business transferred a property from its investment portfolio to its (separate) trading portfolio, and has commenced redevelopment, will give a less relevant description of the entity's activities. This can be illustrated in the following two scenarios:
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> - In our experience, some large property groups have two property portfolios: an investment portfolio accounted for under IAS 40 and a trading portfolio accounted for under IAS 2 *Inventories*. Prohibiting an entity from transferring a property from IP to inventory when it has in the normal course of business transferred a property from its investment portfolio to its trading portfolio, and has commenced redevelopment, will mean that the measurement basis for trading properties will depend on the purpose for which they were originally purchased, rather than the purpose for which they are being held at the reporting date.
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> - In addition we note that the ED proposes to prohibit for IP the treatment that IAS 16.68A *requires* for items of PPE held for rental and that was introduced by an earlier Annual Improvement: transfer to inventory when the items become held for sale. We are unclear why the Board proposes to diverge further the requirements of the two IASs in this area, deemphasising the role of the entity's business model in the case of IAS 40 having recently emphasised it in the case of IAS 16; this divergence is not acknowledged in, let alone supported by, the Basis for Conclusions to the ED.
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> - An entity that acquires land for an undetermined future use will classify that land as investment property under paragraph 8(b) of IAS 40. If the entity decides subsequently to construct a building on the land and sell the land and the building in the ordinary course of business, then the proposed amendment would prevent the land from being transferred to inventory. Conversely, if that entity had decided immediately on acquisition that it would redevelop the land in the ordinary course of business, then both the land and the building

> potentially would have been classified under IAS 2. We believe that this inconsistency would be an undesirable consequence of the proposed amendment.

> We believe that the ED mischaracterises the proposal as being about "changes from the fair value model to the cost model"; the proposal would change the measurement basis and presentation of IP being redeveloped with a view to sale irrespective of the measurement model the entity applies to IP. For example, if under current IAS 40 an entity applies the cost model for IP and decides to redevelop the IP before a subsequent sale in the ordinary course of the business, then it would transfer the IP to inventory, change the measurement basis to the lower of cost and net realisable value, no longer would be required to identify and account for separate components, and would present any income and expenses from a subsequent sale as revenue and cost of sales rather than income from disposal of IP. Under the proposed amendment to IAS 40, a transfer to inventory no longer would be permitted, resulting in various measurement and presentation consequences

14. This issue was approved by the Board for inclusion within the ED with the primary focus on removing the requirement (and ability) to transfer investment property carried at fair value to inventory when it will be developed for sale. As stated in the ED in the Basis for Conclusions on this issue:

> BC1 The Board identified potentially inconsistent guidance regarding the classification of an investment property when management intends to sell it. Some read the guidance in paragraph 58 as requiring the investment property to be classified as inventories in accordance with IAS 2 *Inventories*, whereas the guidance in paragraph 56 requires the investment property to be classified in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

> BC2 The Board noted that the original classification of an asset as either investment property or inventory depends on the specific fact pattern of the entity. The Board noted that requiring investment property to remain within investment property after its initial classification is consistent with other changes of use for investment property, such as the treatment of investment property under construction and investment property that is redeveloped for continued use as investment property.

> BC3 The Board concluded that continuing to measure the property using the measurement model previously selected in accordance with IAS 40 provided the most relevant information. In addition, the Board concluded that providing disclosures similar to those required by IFRS 5 gave comparable information about the intended sale of investment property regardless of whether further development was required before sale.

15. The staff acknowledges several of the concerns raised in comment letters with respect to the internal consistency within IAS 40, consistency with other current IFRSs and the desire to review IAS 40 (and IFRS 5) on a comprehensive basis. Therefore, the staff recommends that the proposed reclassification issue be re-considered on a comprehensive basis to ensure consistency with other IFRSs and recent Board decisions in other active projects.

IFRS 5 disclosures

Applicability of IFRS 5 disclosures

16. One aspect of the proposed amendment is to require IFRS 5 disclosures when an entity decides to dispose of an investment property. This requirement to provide IFRS 5 disclosures would be applicable regardless of whether the investment property meets the criteria to be classified as held for sale. Proposed paragraph 58A of the ED states:

> An entity that decides to dispose of an investment property shall:
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> (a) apply IFRS 5 if the investment property meets the criteria to be classified as held for sale (or are included in a disposal group that is classified as held for sale), or
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> (b) continue to apply this Standard and shall provide the disclosures required by paragraphs 38 and 40–42 of IFRS 5 if the investment property does not meet the criteria to be classified as held for sale.

17. Several respondents commented that the proposal to require IFRS 5 disclosures even when the criteria to be classified as held for sale are not met is not appropriate and onerous. Two of those respondents stated, in part:

> A ...we have some concerns with regard to the proposed paragraph 58A(b) requiring that an entity that decides to dispose of an investment property shall continue to apply IAS 40 and shall provide the disclosures required by paragraphs 38 and 40-42 of IFRS 5 if the investment property does <u>not</u> meet the criteria to be classified as held for sale. In our view, as long as an investment property does not meet the criteria to be classified as held for sale requiring disclosures of IFRS 5 is neither necessary nor consistent with other IFRSs, for example IAS 16.
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> B … we do not agree with the proposal to require the relevant disclosures in IFRS 5 when the investment property does not meet

> the criteria of IFRS 5 to be classified as held for sale as if the criteria were met. In our opinion, requiring such disclosures in the case of an investment property that is not classified as held for sale would not enhance the usefulness of the information provided and therefore we consider them unnecessary.

18. As stated previously in this Agenda Paper, the Basis for Conclusions to the ED included the Board's rationale 'that providing disclosures similar to those required by IFRS 5 gave comparable information about the intended sale of investment property regardless of whether further development was required before sale.'

19. Regarding the use of and reference to IFRS 5 disclosures when an entity decides to sell an investment property, the staff agree with respondents that any specific disclosure guidance should be added directly within IAS 40 to describe the disclosures an entity shall provide. The staff also acknowledges concerns raised requiring IFRS 5 disclosures regardless of whether an entity meets the scope criteria in IFRS 5 or not. The staff recommends that these disclosures be condensed from the disclosures required by IFRS 5 to address the material aspects of the entity's decision to sell the investment property (i.e. tailored to the specific circumstances).

Referencing to and from IFRS 5

20. Several respondents stated that if the Board does reaffirm that disclosures are necessary when an entity decides to sell an investment property, then all disclosure requirements should be contained within IAS 40 and not referenced to IFRS 5. Specifically, instances where the criteria to be classified as held for sale are not met, several respondents commented that it is confusing to be referred to IFRS 5. Further, for those investments measured at fair value, paragraph 5 of IFRS 5 excludes the measurement of those assets and refers back to the original standard for measurement guidance (i.e. IAS 40 for investment property).

21. The staff also agrees that referencing back and forth to IFRS 5 should be avoided. The staff does not believe it is necessary to make a direct reference to IFRS 5 simply as a reminder that if the criteria in IFRS 5 are met an entity shall apply those provisions since IFRS 5 (and all other IFRSs) should be applied if they are applicable.

Overall staff recommendation and questions for the IFRIC

22. Based on detailed analysis included in this paper, the overall staff recommendation is to recommend the Board:

    (a) not finalise this proposed amendment as drafted within the ED;

    (b) remove this issue from the *Annual Improvements* project; and

    (c) include this issue on the Board's list of future projects (including acknowledgement of current Board work plan does not allow this project to be actively started in the near term).

23. The rationale supporting the overall staff recommendation includes:

    (a) the mixed views expressed by respondents in support of vs against the proposed amendment as drafted in the ED which the staff believes provides evidence that this issue is not seen by constituents as a 'quick fix' without significant redeliberation and re-exposure. Issues raised include inconsistencies within the proposed amendment and inconsistencies with the recently completed amendment to IAS 16;

    (b) the approximately one-third of respondents (that provided any response to this issue) directly answering the Board's Invitation to Comment Question 5 supporting a separate project be undertaken for this issue;

    (c) the interaction of this issue with other IFRS 5 issues has not been comprehensively analysed. Other recent IFRS 5 issues being deliberated by the Board including those issues that have been incorporated into the project on Discontinued Operations expected to issue a final amendment in Q1 2010 as well as issues that have been deliberated by the Board and deferred until a comprehensive post-implementation review of IFRS 5 is performed. Additionally, the IFRIC has deliberated several narrow IFRS 5 issues in the past year; and

    (d) the current Board work plan and timelines for existing major projects to be completed.

Question 1 – Overall staff recommendations
Does the IFRIC agree with the overall staff recommendations included in this paper to recommend the Board: (a) not finalize this proposed amendment as drafted in the ED; (b) remove this issue from the *Annual Improvements* project; and (c) include this issue on the Board's list of future projects?

Question 2 – Other paths forward for this issue
If the IFRIC does not agree with the overall staff recommendations included in this paper, what recommendations does the IFRIC have and how should the staff proceed with this issue?

Other issues for this project

24. Provided the IFRIC agrees with the staff recommendation not to finalise this proposed amendment, the staff believes deliberation is not necessary for 'other issues' including:

    (a) re-exposure,

    (b) effective date and transition, and

    (c) first-time adoption.

Question 3 – 'Other issues' for this project
Does the IFRIC agree that redeliberation is not necessary for the other issues of re-exposure, effective date and transition and first-time adoption?